



Michigan State Employees

Retiree Health Actuarial
Valuation Results
as of September 30, 2011



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Retiree Health Benefits

The Funding Issue

- ◆ Unlike pensions, health benefits have not been pre-funded (most pension plans nationwide have not pre-funded health benefits either)
 - ▶ No investment income to help pay the costs
- ◆ Costs rise as more members retire, and health inflation outpaces general inflation
- ◆ Pre-funding contribution rates have been calculated since 1999 – but pre-funding contributions have not been made



Governmental Accounting Standards Board

- ◆ Beginning with the 2007 CAFR, GASB Statements No. 43 and No. 45 specify how retiree health benefit liabilities and expenses are reported in financial statements
- ◆ The reported annual expense is called the Annual Required Contribution (ARC)
- ◆ If the employer fully funds the actuarially computed ARC, in a qualified trust with a long-term investment policy, then the liabilities and ARC are based on a long range investment return assumption (approximately 8%)
- ◆ If the employer only pays the cash benefits, with no pre-funding, the liabilities and ARC are based on a short term investment return assumption, like that earned on the employer's general accounts (approximately 4%) – and the liabilities and ARC are much larger



Governmental Accounting Standards Board

- ◆ The reported liability and ARC depend on how the employer is funding the benefits
- ◆ If the employer funds more than the cash benefits but less than the full actuarial contribution (partial pre-funding), the liabilities and ARC will lie somewhere between the pre-funding and cash funding results
- ◆ Existing employer contributions to pay the cash benefits count as contributions toward meeting the ARC
 - ▶ Medicare Part D Retiree Drug Subsidy (RDS) payments received during the year may also count as employer contributions toward meeting the ARC



SERS – GASB Compliant Valuation

- ◆ Annual Expenditures for Retiree Health Care Benefits:

- ▶ FY 2011: \$473 million

- ◆ 2011 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2012</u>
Full Actuarial Funding	\$8.9 billion	\$715 million

Potential Unfunded Liability and ARC from September 2011 actuarial valuation.

Annual Expenditures from the SERS 2011 Comprehensive Annual Financial Report.



SERS – GASB Compliant Valuation

Full Actuarial Funding

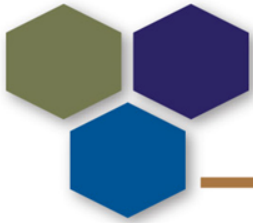
◆ 2011 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2012</u>
Full Actuarial Funding	\$8.9 billion	\$ 715 million
Less Actual FY2011 Employer Contribution		<u>\$(453 million)</u>
Additional Employer Contribution to Fully Fund the ARC		\$ 262 million

- ◆ Lump sum of \$8.9 billion would fully fund the 2011 unfunded liability
- ◆ Once fully funded, the annual employer contribution requirement decreases to the normal cost
- ◆ Employer normal cost is \$128 million in FY2012

Potential Unfunded Liability and ARC from September 2011 actuarial valuation.

Actual FY2011 Employer Contribution from the SERS 2011 Comprehensive Annual Financial Report.



SERS – GASB Compliant Valuation

Full Actuarial Funding vs. Cash Funding

- 2011 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2012</u>
Full Actuarial Funding	\$ 8.9 billion	\$ 715 million
Cash Funding	\$14.3 billion	\$ 961 million

- Lump sum of \$8.9 billion would fully fund the 2011 unfunded liability (annual normal cost thereafter).
- The \$14.3 billion amount is for reporting and disclosure purposes (if cash funding is continued), and is not an amount that needs to be funded in a lump sum.
- \$5.4 billion (\$14.3 less \$8.9) represents some of the lost investment income from not pre-funding.

Potential Unfunded Liability and ARC from the September 2011 actuarial valuation.



SERS – GASB Compliant Valuation

Impact of Cash Funding Policy (Pay-go)

- ◆ No investment income to help pay the costs
 - Higher liability reported, compared to full actuarial funding
- ◆ Reported liability on State's balance sheet
 - Page 90 of State of Michigan 2011 CAFR
 - Only 44.5% of Annual OPEB Cost was contributed
 - \$2,100.4 million Net OPEB Obligation



Circumstances That Would Increase Projected Costs

- ◆ Medicare funding reductions or cost shifting
- ◆ Unexpected new entrants into the retiree health plan (from health benefit cutbacks of other employers)
- ◆ Medical inflation worse than assumed; the actual future contributions will depend on future per capita health cost increases (health inflation) *
- ◆ Active member population decline (contribution rates as a percentage of payroll would increase)
- ◆ This is not a complete list

* *Per capita costs are projected to increase 9% the first year, graded down to 3.5% in the tenth and later years.*



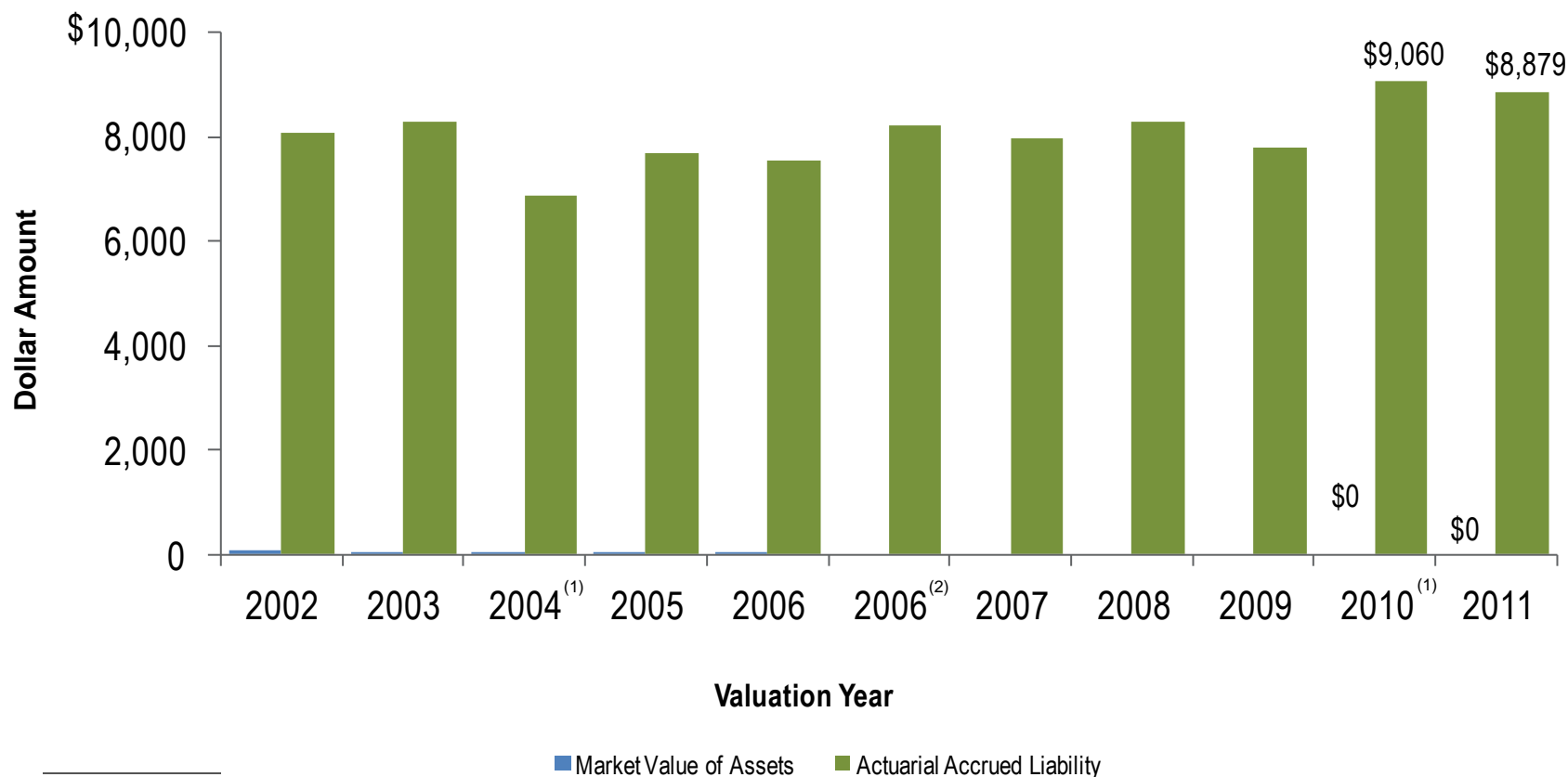
Solutions and Observations

- ◆ Strategic planning – an important tool to contain costs while delivering valuable benefits
- ◆ Plan for increases in employer health care contributions
- ◆ Partial pre-funding (more than cash funding, but less than GASB ARC) may protect against higher costs if experience is worse than projected



Health Assets & Accrued Liabilities

Full Actuarial Funding (Amounts in Millions)

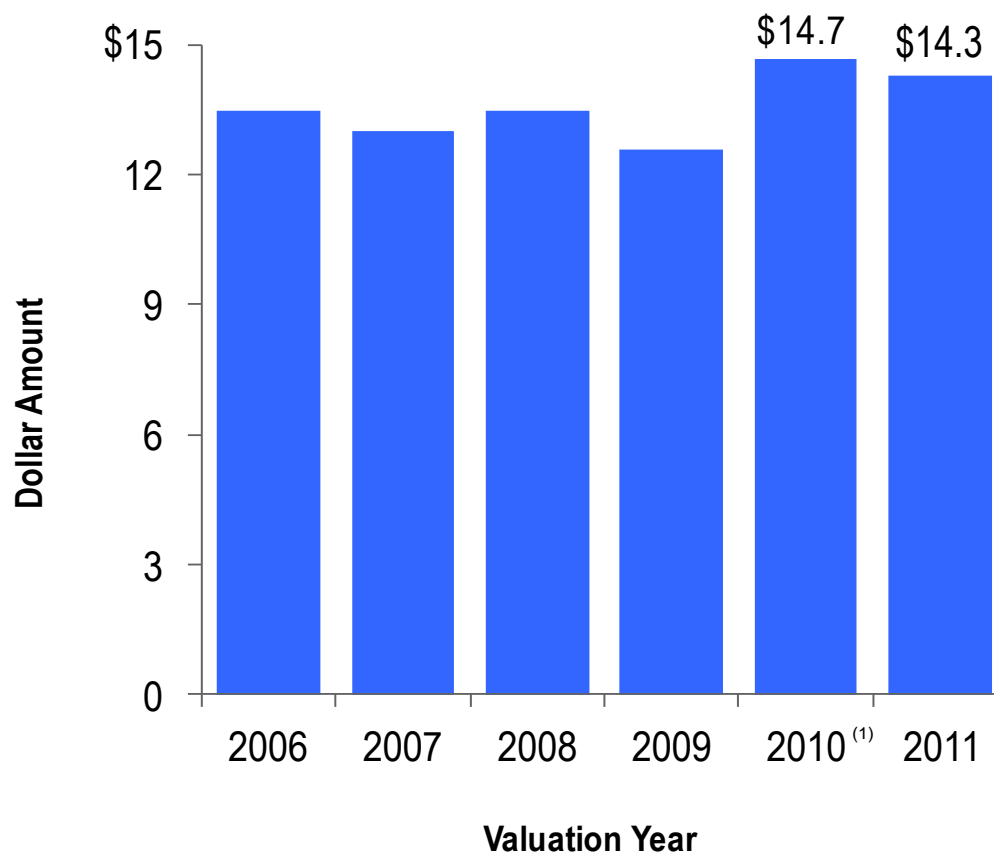


⁽¹⁾ Reflects assumption changes.

⁽²⁾ Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45.



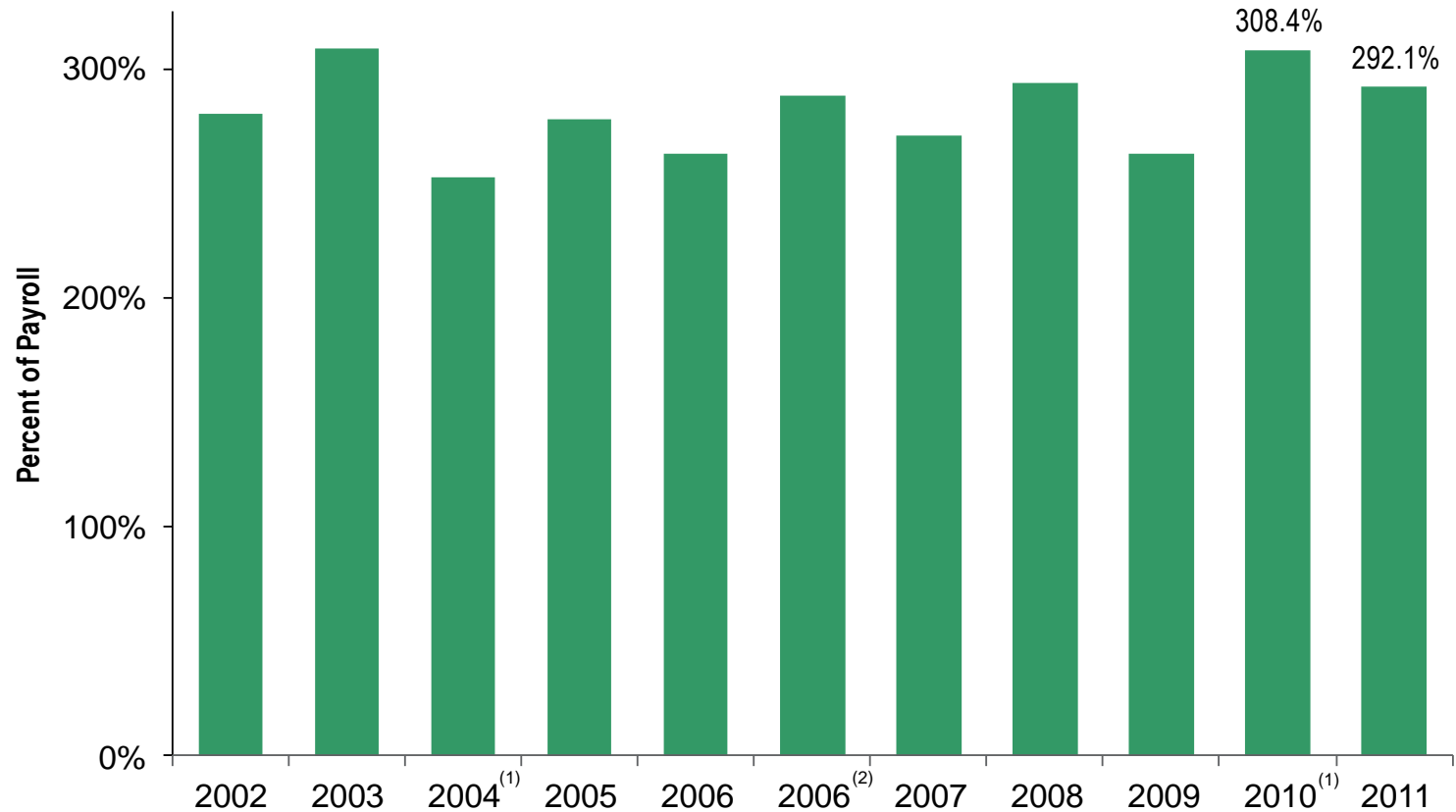
Health Accrued Liabilities Cash Funding (Pay-go) (Amounts in Billions)



⁽¹⁾ Reflects assumption changes.



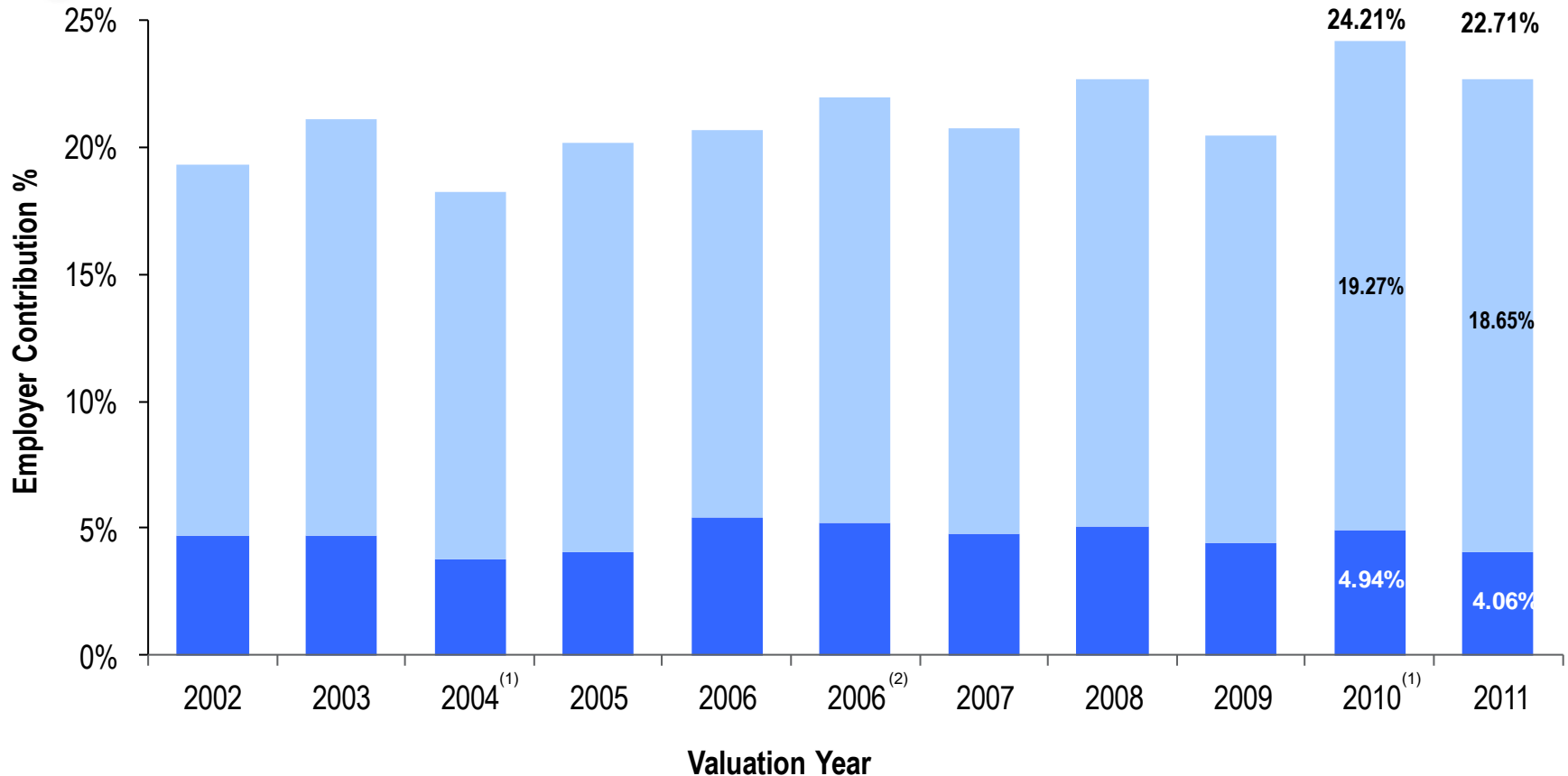
Unfunded Accrued Liabilities as % of Payroll – Full Actuarial Funding



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⁽²⁾ Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45.

Annual Required Contributions (ARC) as Percents of Payroll (Full Actuarial Funding)

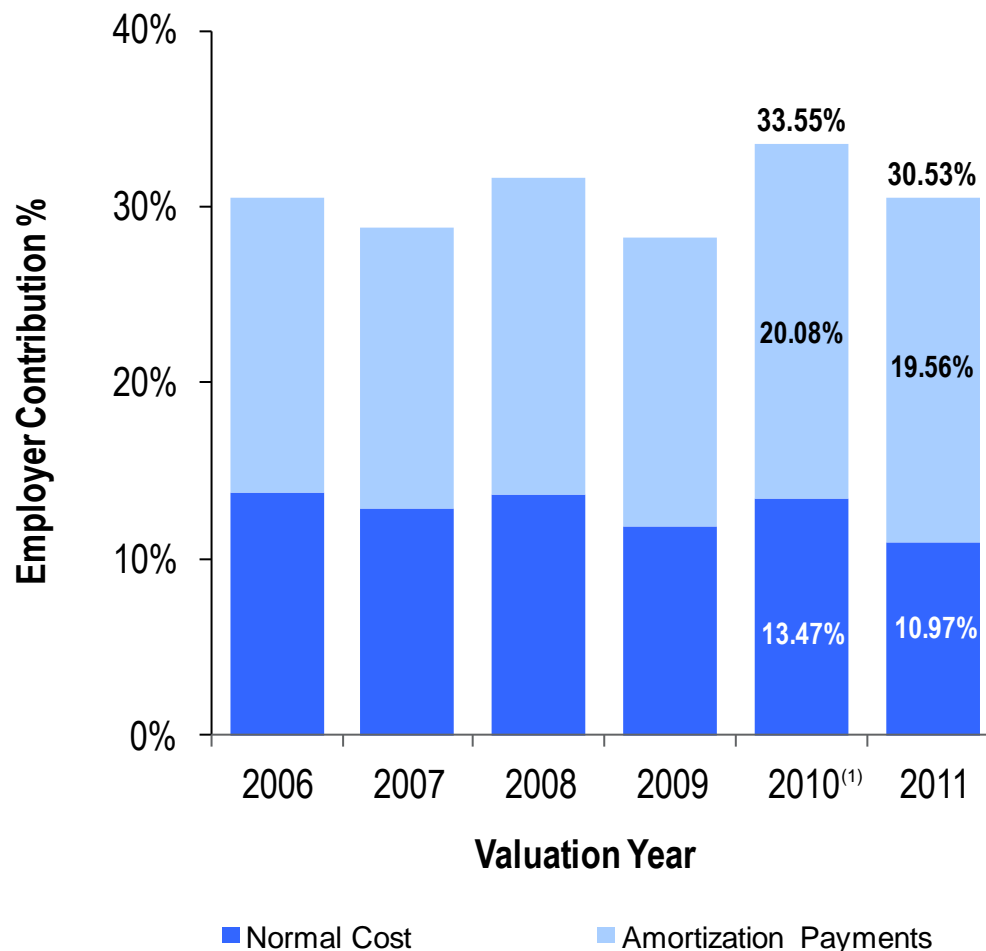


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Annual Required Contributions (ARC) as Percents of Payroll (Cash Funding – Pay-go)



⁽¹⁾ Reflects assumption changes.



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